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C O N F I D E N T I A L SECTION 01 OF 03 TEL AVIV 002517

SIPDIS

NEA FOR FRONT OFFICE; NEA/IPA FOR WILLIAMS, GREENE,  
WAECHTER; NSC FOR ABRAMS, LOGERFO; TREASURY FOR ADKINS,  
SZUBIN

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SUBJECT: MOF CONFIDENT BANKING CRISIS WILL BE RESOLVED

REF: TEL AVIV 2301

Classified By: Economic Counselor William Weinstein for reasons 1.4 b a  
nd d.

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Summary  
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11. (C) Stressing the need to prevent a humanitarian crisis in the territories, the Ministry of Finance (MOF) DG Yossi Bachar and his senior advisor said on June 20 that the Temporary International Mechanism (TIM) was acceptable to the MOF as long as it did not become an avenue for sending funds to the PA's Hamas government. They expressed frustration regarding the issue of supplying medical assistance to the Palestinians, with Bachar saying that "everyone involved is dealing with determining a proper mechanism rather than actually getting assistance to those who need it." On the Israel-Palestinian banking issue, they said that all of those involved understood the importance of resolving the issue, and were confident that the banks' agreement to delay cutting off the Palestinian banks until August 15 would provide sufficient time to find a solution. On the possibility of revisiting and signing onto the customs agreement in order to subject those crossing the Israel-Gaza border to internationally-recognized limitations on the transport of currency and giving the EU-BAM something concrete to monitor, they said that doing so would require a political decision by the Prime Minister's office. Bachar also expressed deep concern regarding allegations of corruption and inefficiencies at Karni that were impeding the movement of U.S. products into the territories, and offered to facilitate a meeting for the Economic Counselor with the temporary Chief of the Airport Authority to discuss the problems. End summary.

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Temporary International Mechanism  
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12. (C) At a June 20 meeting between NEA/IPA Director Williams, the Economic Counselor and Deputy Counselor, and Finance Ministry DG Yossi Bachar and Senior Advisor to the DG, Rani Loebenstein, Bachar stressed the need to prevent a humanitarian crises among the Palestinians, which he said would ultimately hurt Israel as well. He noted that the TIM was acceptable to the Finance Ministry as long as it does not become an avenue for sending funds to the PA's Hamas government. Loebenstein explained that the GOI's main concern is that the data to be used to determine where the money should go will all originate from Hamas. Will the doctors and teachers designated to receive the funds be real doctors and teachers? He said that an earlier attempt in 2002 to inspect PA expenditures by means of the World Health Organization and an international accounting firm came to naught, and wondered why this time would be different. Williams replied that any money paid would be a "stipend, not a salary." Salaries are a "red line," for the EU as well, and would remain the responsibility of the Hamas government. He added that the TIM would show the international community's concern for the Palestinians, maintain essential services in the health sector, and give the donors the opportunity to remain involved, consistent with the requirements of the Quartet. Bachar noted that the effect of the political friction between Hamas and Fatah was beyond any outsider's control.

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NIS 50 million Medical Assistance  
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13. (C) With regard to the provision of NIS 50 million in medical assistance to the Palestinians from PA customs fees that Israel has been collecting, Bachar noted that this is another instance where everyone involved is dealing with determining a proper mechanism rather than actually getting assistance to those who need it. He called it a "very delicate situation with no magic solution." In response to the Economic Counselor's question as to whether the TIM could be used as a conduit for the medical assistance funds, Bachar said it was not clear if the Palestinians would agree.

Loebenstein said that the GOI will be holding a total of about NIS 750 million in Palestinian revenue by the end of June.

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Banking Relationships  
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14. (C) Bachar said that the GOI had been close to an agreement with Israeli banks that would have allowed them to continue their relationships with private Palestinian banks. However, Bachar admitted that the Attorney General had solid legal reasons for not accepting the proposed agreement. The Israeli banks agreed to extend their deadline for cutting off relations with Palestinian banks from July 5 until August 15, to allow more time for the negotiations to succeed. Bachar stressed that the issue must be resolved in a way that will fully satisfy the Attorney General as to its legality. He added that the Bank of Israel (BOI) is interested in maintaining the shekel as the chief Palestinian currency, which would only be possible were the banks to maintain their relationships.

15. (C) Loebenstein said that the changes required in banking regulations would not be merely administrative but would likely require the Knesset to consult with BOI regulators and then approve the changes. In addition, Palestinian banks will also have to comply with more stringent requirements such as including more information on checks to make it easier to track the flow of funds. He said that the Israeli banks also want the U.S. Treasury to somehow affirm the agreement so as to have some assurances that they would not run afoul of U.S. anti-terror-finance laws. Bachar added that the situation involves many complex legal issues and needs to be worked through carefully. Williams noted that the only recent change regarding terrorist financing pertained to dealings with those parts of the PA government now controlled by Hamas -- other restrictions on dealing with FTOs remained the same. He asked why Israeli banks are so concerned now? Bachar replied that the election of the Hamas government has shined a spotlight on the issue of financial dealings with the Palestinians, engendering in Israeli banks an increased sense of risk across the board. Loebenstein noted that the accusations against the Arab Bank in New York last year had also increased awareness of the anti-terror finance issue among banks worldwide. Bachar said he was optimistic that a solution to the problem would be found because all of the parties involved, including the Attorney General, understood the need to resolve it. He added that Loebenstein is handling the issue for the MoF, and is working closely with the Ministry of Justice and the BOI.

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British Gas  
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16. (C) The Economic Counselor asked if the Palestinians are interested in selling gas to Israel via British Gas. Bachar said that they were playing their cards very closely, and noted that they have not yet exercised their influence on the issue. He added that Israel has made a strategic decision not to rely exclusively on Egyptian gas.

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Hamas Money Smuggling  
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17. (C) The Economic Counselor raised the issue of the inability of the EU-BAM to monitor Hamas smuggling of large amounts of cash across the Gaza border. He remarked that the Palestinians had signed a customs agreement covering movement from Rafah to Gaza and suggested that it would be worthwhile for the GOI to revisit and sign onto the customs agreement as well. Activating it would enable the application of international limitations on the movement of currency at the crossings and would give the EU-BAM something concrete to monitor. This would, for example, require the reporting of more than USD 10,000 in cash by any individual. Loebenstein said that everything the GOI had feared would happen as a result of disengagement regarding the issue of "leaky borders" was now happening. He added that the customs agreement was a political issue which would have to be decided on by the office of the Prime Minister.

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Corruption at Karni  
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18. (C) The Economic Counselor then raised the issue of corruption at Karni, which has become a significant U.S.-Israel trade problem impeding the distribution of U.S. products in the territories (see reftel). He added that the reservation system for moving products at Karni is not transparent, efficient, or logical, aside from the allegations of corruption. He also said that USAID has funds available for improving efficiency at border crossings, such as setting up an internet sign-up system which will tell

every transport company where its load stands in the queue.  
Bachar indicated that these problems were of great concern  
and offered his help in setting up a meeting for the Economic  
Counselor with Shaul Tsemach, the temporary Chief of the  
Airport Authority, whose office is located in the Finance  
Ministry.

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